



# Legislative Audit Division

State of Montana

Report to the Legislature

October 2006

## Performance Audit

### Right-of-Way Acquisition Process

#### Right-of-Way Bureau Montana Department of Transportation

The Montana Department of Transportation requested a performance audit of its right-of-way acquisition process. This report contains conclusions related to the department's process to acquire right-of-way and recommendations to improve controls over the process. Conclusions and recommendations include:

- The right-of-way acquisition process has strengths:
  - ▶ Parcels are appraised to determine fair market value.
  - ▶ Qualified appraisers conduct appraisals.
  - ▶ Appraisals and negotiations are conducted independently.
- Improvements to the right-of-way acquisition process should include:
  - ▶ Involving Review Appraisers in developing scope-of-work.
  - ▶ Updating outdated appraisals prior to initial offers.
  - ▶ Clarifying department negotiation policies.
  - ▶ Justifying and supporting administrative settlements.
  - ▶ Developing a coordinated quality control system.

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## PERFORMANCE AUDITS

Performance audits conducted by the Legislative Audit Division are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy. The audit work is conducted in accordance with audit standards set forth by the United States Government Accountability Office.

Members of the performance audit staff hold degrees in disciplines appropriate to the audit process. Areas of expertise include business and public administration, mathematics, statistics, economics, political science, criminal justice, computer science, education, and biology.

Performance audits are performed at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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# LEGISLATIVE AUDIT DIVISION

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James Gillett  
Jim Pellegrini

October 2006

The Legislative Audit Committee  
of the Montana State Legislature:

This is our performance audit of the Montana Department of Transportation's right-of-way acquisition process. The audit was requested by the department and approved by the Legislative Audit Committee. Right-of-way is property the department purchases for highway construction purposes.

This report contains conclusions identifying the strengths of the department's process to acquire right-of-way. It also contains recommendations to improve controls over the process and improve general management of the process.

We wish to express our appreciation to the staff of the department for their cooperation and assistance during the audit.

Respectfully submitted,

*/s/ Scott A. Seacat*

Scott A. Seacat  
Legislative Auditor

# **Legislative Audit Division**

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## **Performance Audit**

### **Right-of-Way Acquisition Process**

**Right-of-Way Bureau**

**Montana Department of Transportation**

Members of the audit staff involved in this audit were Lisa Blanford,  
Joe Murray and Kent Wilcox.

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## **Appointed and Administrative Officials**

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### **Montana Department of Transportation**

Jim Lynch, Director  
Jim Currie, Deputy Director  
Loran Frazier, Administrator, Engineering Division  
John Horton, Bureau Chief, Right-of-Way Bureau

### **District Administrators**

Dwane Kailey, Missoula  
Jeff Ebert, Butte  
Michael Johnson, Great Falls  
Ray Menael, Glendive  
Bruce Barrett, Billings

### **Transportation Commission**

William T. Kennedy, Chair, Billings  
Nancy Espy, Vice Chair, Broadus  
Deb Kottel, Great Falls  
Rick Griffith, Butte  
Kevin Howlett, Arlee



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### Introduction

The Montana Department of Transportation (MDT) purchases property from private and public property owners to construct the state's highways and bridges. Property purchased for highway construction purposes is referred to as right-of-way. MDT officials requested a performance audit of the department's right-of-way acquisition process to determine if administrative settlements used to acquire property were "supported and justified." Administrative settlements are payments to property owners based on an agreed upon value of the property acquired that exceed the property's appraised value. The Legislative Audit Committee approved the department's request and prioritized a performance audit of the right-of-way acquisition process.

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### Federal and State Laws Protect Property

Protecting property owners is the fundamental principle of federal and state laws related to right-of-way acquisition. The purpose of these laws is to ensure property owners are fairly compensated for property acquired for public use. Federal and state laws governing the right-of-way acquisition process are found in the:

- ▶ U.S. Constitution
- ▶ U.S. Code
- ▶ Montana Constitution
- ▶ Montana Code

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### The Right-of-Way Acquisition Process

Right-of-Way acquisition is the responsibility of MDT's Right-of-Way Bureau and five district offices. Right-of-way acquisition can be a difficult task because MDT is generally trying to acquire property that is not for sale and property owners can be reluctant to sell. Consequently, the acquisition process often does not involve a willing buyer-seller relationship. Acquiring right-of-way involves two main steps - property valuation and negotiating the purchase with property owners. Property valuation is the process of appraising property to determine its fair market value and the amount of compensation to be offered to property owners. Once compensation is determined, the department begins formal negotiations with property owners to purchase the property.

## Report Summary

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### Four Types of Acquisition

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MDT efforts to acquire property can result in four different types of settlements. These include:

1. Negotiated settlement – Negotiated settlements occur when property owners agree to settle for what the department determines is just compensation based on the property's appraised value.
2. Administrative settlement – Administrative settlements occur when property owners and the department reach a final settlement that is more than the appraised value (i.e. just compensation determination) and are often used to resolve differences in opinion between property owners and MDT.
3. Legal settlement – If a negotiated or administrative settlement cannot be reached, negotiations transfer to MDT's Legal Division. Legal Division staff conduct further negotiations with property owners. A legal settlement occurs when negotiations between MDT's legal staff and the property owners result in the department successfully acquiring the property.
4. Condemnation – Condemnation is not used until all attempts to reach a mutually satisfactory agreement through negotiations are exhausted. In the last twelve years, only three parcels of property have gone through formal condemnation proceedings (i.e. referred to a jury for trial).

### How Much Right-of-Way Has Been Purchased?

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During federal fiscal years 2004 and 2005, the department acquired 1,644 parcels of right-of-way costing approximately \$24.8 million. This total included roughly \$2.7 million in negotiated settlements where the department and property owners settled for the parcel's appraised value. Approximately \$18 million was spent acquiring parcels using administrative settlements. These settlements included payments to property owners of approximately \$10.3 million for the parcel's appraised value plus an additional \$7.7 million over appraised value. The remaining costs to acquire property were for legal settlements.

### The Right-Of-Way Acquisition Process Has Several Strengths

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Audit work concluded MDT's right-of-way acquisition process has a number of strengths that ensure the process generally works as intended. These strengths include:

- ▶ The department appraises all property it acquires for right-of-way to determine fair market value.

- ▶ Department staff and private sector appraisers meet needed qualifications to appraise property for right-of-way.
- ▶ Appraisals are independently reviewed and approved by appropriate department personnel.
- ▶ Staff responsible for appraisals and negotiations work independently of each other. Negotiations are well documented and department staff emphasizes fair and positive interactions with property owners.
- ▶ Most property owners indicate they were allowed input into the process and treated professionally by MDT staff.

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### **Improving the Appraisal and Negotiation Process**

MDT acquires a substantial portion of its right-of-way through administrative settlements with property owners. We noted improvements in several MDT control areas could help the department better justify and support administrative settlements.

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### **Improvements in the Appraisal Process Could Strengthen Controls**

Property was not always appraised using the most appropriate appraisal format. Appraisals did not always use appropriate comparable properties or include replacement items (such as septic tanks or fencing) when calculating fair market value. Using incorrect appraisal formats does not ensure property owners are offered just compensation in initial written offers to acquire property. As a result, administrative settlements were used to correct valuation errors caused by incorrect appraisal formats. Appropriate appraisal formats were not always used because the department's Review Appraisers were generally not involved in establishing an appraisal's scope-of-work. Therefore, they had limited input in determining the type of appraisal and potential issues that could arise affecting the value of the property. The department should improve its appraisal process by involving Review Appraisers in developing the scope-of-work for appraisals.

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### **Offers Based on Outdated Appraisals**

Federal regulations and department policy require the department use a property's current appraised value. However, we noted outdated appraisals were used as the basis to make offers to property owners on several occasions. For example, one parcel had an appraisal that was 525 days old which resulted in the department paying the property owner approximately \$118,000 over the appraised amount

## Report Summary

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(using an administrative settlement) to account for several issues related to the outdated appraisal, including rapidly rising property values. Outdated appraisals also resulted in ineffective negotiations between department staff and property owners. The department needs to ensure appraisals are updated prior to making initial offers to property owners so they reflect current market conditions.

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### **Negotiation Process can be Improved**

Department negotiations with property owners were not always conducted in an efficient manner. These inefficiencies lead to longer negotiations and administrative settlements that increased the cost of acquiring the parcel. Examples of negotiation weaknesses included using outdated information to initiate negotiations with property owners, MDT staff not acknowledging counter offers from property owners, and the department not making counter offers to property owners. We generally did not find documentation indicating MDT staff obtained input from MDT Legal Division prior to discussing condemnation as an option. MDT negotiation policies need to be clarified in several areas including counter offer and response requirements, documentation requirements regarding input from MDT legal staff, and acceptable negotiation tactics and timeframes.

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### **Improving Documentation of Acquisition Activities**

Files did not always contain documentation or information justifying the need for the administrative settlement. Most significantly, as administrative settlement amounts increased there tended to be less documentation supporting or justifying the administrative settlement decision. Federal regulations require decisions to approve administrative settlements be documented and the amount of documentation be commensurate with the size of the settlement. However, department right-of-way policy provides limited guidance on what type of documentation should be maintained to fully support administrative settlement decisions. Current policy should be clarified to improve documentation and better support decisions on why administrative settlements were paid.

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### **Improving Controls in the Acquisition Process**

An important control in right-of-way acquisition is collecting quality data so acquisition activities can be effectively managed. The management information should be used to evaluate if operational or

management changes are needed to improve acquisition activities. Other controls that should exist include on-going communication between the Right-of-Way Bureau and district personnel and an internal quality control program that evaluates the efficiency and effectiveness of the department's right-of-way acquisition process.

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### **Data Collection Problems Impact MDT Reporting and Management Efforts**

Data collection problems are affecting several management and operational areas related to right-of-way acquisition. Examples of data collection problems included some administrative settlements being overstated, time to complete acquisition steps are not measured, and all acquisition costs are not tracked. The department needs to implement a performance measurement system that includes program objectives and performance measures. Once this is completed, the department needs to collect data that is relevant, complete, and accurate to determine if objectives are being met.

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### **Improve Intra-Department Communication**

MDT uses a decentralized organizational structure to acquire right-of-way. We identified limited communication taking place between district office staff and Right-of-Way Bureau (Helena) personnel regarding right-of-way acquisition activities. For example, districts do not always obtain bureau approval, as required, to pay administrative settlements over district dollar authority. In a decentralized organizational structure, districts have a tendency to focus on their immediate activities and become less involved or separated from other department functions. The department needs to identify and implement strategies to improve intra-department communications.

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### **Implementing a Quality Control System**

An underlying reason we identified weaknesses in the right-of-way acquisition process was the department did not have a quality control system in place. Agencies implement quality control systems to verify staff comply with established policies and monitor program activities and operations. The department is in the process of developing a quality control system for the acquisition process. However, the process they are developing places responsibility for quality control reviews at the district level. To ensure statewide consistency and compliance with right-of-way laws and policies, the department's quality control system should include both district and

## **Report Summary**

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Right-of-Way Bureau personnel. The department needs to modify its quality control system to ensure it provides statewide consistency and compliance in right-of-way acquisition

# Chapter I – Introduction

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## Introduction

The Montana Department of Transportation (MDT) purchases property from private and public property owners to construct the state's highways and bridges. Property purchased for highway construction purposes is referred to as right-of-way. MDT officials requested a performance audit of the department's right-of-way acquisition process to determine if administrative settlements used to acquire property were "supported and justified." Administrative settlements are payments to property owners based on an agreed upon value of the property acquired that exceed the property's appraised value. The Legislative Audit Committee approved the department's request and prioritized a performance audit of the right-of-way acquisition process.

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## Audit Objectives

To address the department's request we developed three objectives. These were to:

- ▶ Evaluate the department's process to both appraise property and to determine just compensation offered to property owners.
- ▶ Determine if administrative settlements with property owners are supported and justified.
- ▶ Evaluate controls in right-of-way acquisition including management information, communication and coordination, and quality control.

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## Audit Scope and Methodologies

Audit scope focused on right-of-way parcels where MDT entered into an agreement for acquisition with property owners during federal fiscal year 2004 and 2005 (October through September). A settlement is formally reached when a Right-of-Way Agreement is signed by both MDT and the property owner for a price agreed to by both parties. Our audit objectives were addressed by conducting the following audit work:

- ▶ Reviewed state and federal laws and regulations.
- ▶ Reviewed MDT and Federal Highway Administration (FHWA) Right-of-Way acquisition policies and guidelines.
- ▶ Interviewed FHWA officials.
- ▶ Interviewed MDT management, Right-of-Way Bureau officials, and District right-of-way staff.
- ▶ Interviewed MDT legal personnel regarding the right-of-way acquisition process.

## Chapter I – Introduction

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- ▶ Interviewed private sector appraisers (fee appraisers).
- ▶ Reviewed a sample of 32 right-of-way acquisition files. A minimum of five files were reviewed for each district office.
- ▶ Reviewed a judgmental sample of contracts between MDT and fee appraisers.
- ▶ Analyzed the usefulness of MDT management information related to right-of-way acquisition activities.
- ▶ Interviewed MDT information technology personnel.
- ▶ Reviewed information from other states and the federal government about the right-of-way acquisition process.
- ▶ Reviewed MDT's survey of property owners from whom it obtained property.

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### **Montana Department of Transportation's Right-of-Way Acquisition Organization**

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Responsibility for acquiring right-of-way lies within the department's Right-of-Way Bureau (bureau) and five district offices. The following sections provide a brief description of the responsibility for each in acquiring property for right-of-way.

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#### **Right-of-Way Bureau**

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The bureau is responsible for designing right-of-way, acquiring property for highway and bridge construction projects, managing acquired land, and providing assistance and payments to individuals, businesses, and utilities relocated because of highway construction. The bureau also coordinates its activities and maintains a liaison with other department functions, district offices, and the FHWA concerning property acquisition and other bureau programs.

The Right-of-Way Bureau is located in Helena and provides general guidance over the right-of-way process. The Helena office establishes right-of-way policy and procedures, provides technical expertise and general oversight on right-of way issues, and manages and allocates right-of way resources. The bureau is responsible for ensuring the acquisition process follows right-of-way policies and procedures. The bureau has a total of 49 FTE. This includes 8 FTE comprised of bureau management (Bureau Chief, Operations Manager), and administrative support. There are also seven sections that carry out day-to-day operations totaling 41 FTE. Each section



and the FTE in each is described below. A supervisor administers activities for each of the following sections:

1. Design/Plans Section (11 FTE) – Designs right-of-way and utility plans, prepares legal descriptions, deeds, and exhibits needed for right-of-way acquisitions.
2. Appraisal Section (5 FTE) – Conducts valuations of property to be acquired by MDT. This includes developing appraisal policies, providing training for staff development, arranging for services by private sector appraisers, reviewing all appraisals prepared for the department, determining the amount of compensation the department should pay for property, and monitoring the quality of appraisals.
3. Acquisition Section (3 FTE) – Approves purchases of property needed for right-of-way. This includes developing acquisition policies, ensuring compliance with federal and state laws and regulations, reviewing and approving purchases and administrative settlements over \$10,000, coordinating the processing of condemned parcels, and training staff negotiators. In some instances, highway projects result in the displacement of individuals, families, and businesses. The Acquisition Section provides assistance to displaced individuals to move to comparable housing or find suitable replacement locations for businesses.
4. Real Estate Services Section (7 FTE) – Administers the department's property management programs, oversees the bureau's audit/compliance program, authorizes payments for land purchases, and maintains records/files for parcels purchased by the department.
5. Special Programs Section (1 FTE) – Manages specialty acquisitions and appraisals of property acquired such as excess land and ownership studies. Examples include acquiring property for MDT maintenance sites, wetland mitigation, and other environmental mitigation sites.
6. Access Management Section (2 FTE) – Manages physical access to state highways to maintain safe flow of traffic on Montana's highway system.
7. Utilities Section (12 FTE) – Administers the bureau's utility relocation function. This includes developing policies governing utility facilities located in highway right-of-way and securing agreements with utility and railway companies to relocate utilities for highway construction.

## **Chapter I – Introduction**

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### **MDT District Offices**

There are five district offices located in Billings, Butte, Glendive, Great Falls, and Missoula. District Administrators provide overall management of transportation activities within their respective district. District right-of-way supervisors are responsible for district right-of-way activities. Districts are responsible for appraising properties and negotiating property acquisitions with property owners.

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### **Report Organization**

The remainder of the report discusses the following topics:

- ▶ Chapter II provides background information on the right-of-way acquisition process including federal and state laws, property appraisals, and negotiations with property owners.
- ▶ Chapter III presents conclusions on strengths identified in the right-of-way acquisition process.
- ▶ Chapter IV discusses needed improvements in appraising property and negotiating acquisitions with property owners to ensure they are offered just compensation. These include using appropriate appraisal methods to value property, using current appraisals to base offers for property acquisition, and improving department negotiations.
- ▶ Chapter V discusses recommendations to improve MDT's management controls over right-of-way acquisition including data collection and quality control.

# Chapter II – Background

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## Introduction

The Montana Department of Transportation (MDT) purchases property for right-of-way from private and public property owners for construction projects. This chapter provides background information on the department's right-of-way acquisition process. Discussion topics include federal and state laws related to right-of-way acquisition, the process used to appraise property, and department procedures to negotiate and settle on property values with property owners.

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## Federal and State Laws Protect Property Owners

Protecting private property owners is the fundamental principle of federal and state laws related to right-of-way acquisition. The purpose of these laws is to ensure property owners are fairly compensated for property acquired for public use. The following federal and state laws govern the right-of-way acquisition function.

### **Federal Law**

- ▶ U.S. Constitution – The Fifth and Fourteenth Amendments address taking of private property for public use and due process requirements. The Fifth Amendment requires private property owners be paid just compensation for property acquired for public use.
- ▶ U.S. Code – To ensure eligibility for federal-funding participation in transportation projects, property acquisition activities must comply with the Uniform Relocation and Real Property Acquisition Policies Act of 1970 (i.e., Uniform Act). Uniform Act requirements include:
  - Reasonable efforts to acquire property expeditiously, minimize litigation, and pay property owners just compensation for their property.
  - Complete appraisals prior to acquiring property and provide property owners a chance to accompany the appraiser.
  - Written offers to property owners providing a summary on how the amount of the offer was determined.
  - No coercive action forcing property owners to agree on the department's offer for the property.

## Chapter II – Background

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### State Law

- ▶ Montana Constitution – Article II, Sections 17 and 29 address due process of law and eminent domain (i.e., condemnation). The constitution states private property shall not be taken or damaged for public use without just compensation to the full extent of the loss having been first made to, or paid into court for, the landowner.
- ▶ Montana Code – Title 60, Chapter 4, governs MDT’s acquisition and disposition of property. Title 70, Chapters 30 and 31; address the eminent domain code, relocation assistance, and fair treatment of those who had property condemned.

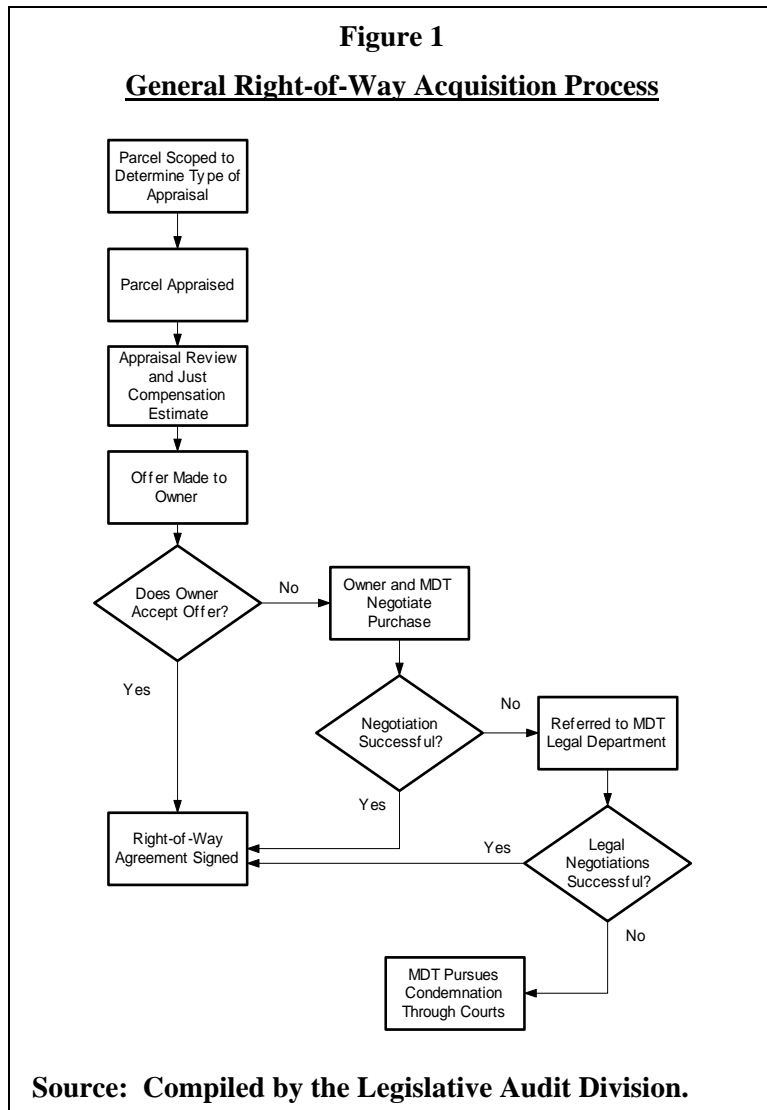
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### **The Right-of-Way Acquisition Process**

Once a construction project is designed and the department knows the amount of right-of-way needed to complete the project, the process of acquiring property begins. Right-of-way acquisition can be a difficult task because the department is generally trying to acquire property that is not for sale and property owners can be reluctant to sell. Consequently, the acquisition process often does not involve a willing buyer-seller relationship.

The amount of property the department needs to purchase from landowners for right-of-way varies, but it generally amounts to a “piece” of property. For example, someone may own 20 acres of land in a project area but the department may only need to purchase a half-acre strip of land along the proposed roadway. In some cases, families, individuals, or businesses occupy land needed for right-of-way and it is necessary to relocate the occupants. In these situations, MDT provides relocation assistance to displaced persons in finding a comparable dwelling and paying moving expenses and other related costs.

Acquiring right-of-way involves two main steps – property valuation and negotiating the purchase with property owners. Property valuation is the process of appraising property to determine its fair market value and the amount of compensation to be offered to property owners. Once compensation is determined, the department begins formal negotiations with property owners to purchase the property. The following flowchart provides a general illustration of the right-of-way acquisition process.



Each step of the right-of-way acquisition process is described in further detail in the following sections.

### **Property Valuation and Just Compensation**

The first step in the right-of-way acquisition process is appraising property and determining the amount of compensation to offer property owners to purchase the property. State and federal laws have provisions requiring property owners receive just compensation for property acquired for public use. According to MDT policy, the purpose of just compensation is to make impacted property owners “whole.” That is, as a result of just compensation property owners

## Chapter II – Background

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are no worse off after the acquisition as the property owner was before the acquisition. This does not mean affected property owners will be exactly the same after the acquisition as they were before, but property owners are “no richer or poorer” because of the department’s acquisition. In all cases, just compensation must consider the fair market value of the property and any improvements.

If property the department needs to acquire constitutes only a part of a larger parcel, state law (70-30-301, MCA) requires just compensation include the depreciation in current fair market value that will accrue to the remaining parcel by reason of its severance from the portion to be acquired and the construction of the improvements in the manner proposed by the department. If MDT is only acquiring a part of the property, there may be damages or benefits to the remaining property. Any allowable damages or benefits are reflected in the just compensation amount. If the department determines the remainder property will have little or no value or use to the property owner, it considers the remainder an uneconomic remnant and will offer to purchase it. Property owners have the option of accepting the offer for purchase of the uneconomic remnant or keeping the property.

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### **How is Just Compensation Determined?**

To determine just compensation, property must be appraised and documented in an approved appraisal report. An appraisal report is a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion of the defined value of the property. The appraisal report is to contain the appraiser’s estimate of fair market value, data on which the opinion is based, and a narrative supporting how the appraiser’s conclusion was reached. An appraisal is a critical component of right-of-way acquisition because it documents the fair market value of the property and is the basis for just compensation offered property owners. Every aspect of the acquisition process, from negotiating purchases with property owners to relocating displaced property owners, begins with an appraisal. While just compensation offered to property owners can be higher than appraised value of the property, federal regulations state it can never be less than appraised value.

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### **Property Valuation Complexity Determines the Type of Appraisal Completed**

In most cases, the appraised value is the measure for just compensation. Federal regulations allow MDT to use different appraisal formats (i.e., reports) depending on the complexity of an appraisal issue. The main differences in the formats are the level of documentation required in the appraisal reports. Either the District Right-of-Way Supervisor or the Right-of-Way Bureau's Appraisal Supervisor decides which type of report will be used. In addition, they are responsible for providing a scope-of-work for the appraisal assignment. A scope-of-work provides known information as it relates to the appraisal assignment and provides direction to the appraiser on the type of appraisal and extent of work to be performed. The most common types of appraisals generally used by MDT to acquire right-of-way are described below.

### **Minimum Standard Appraisals: Determination of Value**

Minimum standard appraisals, called determinations of value (DOV), are used when acquisitions are uncomplicated and low in value. As long as there are no complex valuation issues, any parcel up to \$10,000 can be appraised using the determination of value format. DOV's require less documentation than a detailed appraisal (discussed below) but must still meet minimum appraisal standards. Examples of standard DOV requirements include written appraisal reports, independent and qualified appraisers, and stated opinions of fair market value. DOV's were developed to help streamline the right-of-way acquisition appraisal and acquisition process for uncomplicated and lower value property.

In November 2005, the FHWA increased MDT's authority to appraise property using determinations of value. Specifically, this change allows the bureau to appraise property using a DOV for uncomplicated parcels where estimated property value is between \$10,000 and \$25,000. However, the department must receive written permission from the property owner authorizing MDT to use the DOV format. FHWA and MDT officials said this change was made to help further streamline the right-of-way acquisition process.

### **Detailed Appraisals: Form Appraisals**

A detailed appraisal format must be used for all complex valuations without regard to estimated value of the parcel. MDT calls detailed

## Chapter II – Background

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appraisals for right-of-way acquisitions “form appraisals.” Form appraisals are necessary to ensure all relevant, complex appraisal issues are addressed that significantly impact the value of the property. For example, form appraisals contain opinions on issues such as the highest and best use of the property, severance damages, and special use property. Form appraisal reports must completely document and clearly support data used to form conclusions of fair market value for the property.

Federal regulations require form appraisals comply with national appraisal standards and department appraisal policy. The Uniform Standards of Professional Appraisal Practice (USPAP) are the generally accepted standards for professional appraisal practice in North America. MDT requires appraisers to follow USPAP standards when completing form appraisals for the department. However, there are instances when USPAP has limitations related to Right-of-Way acquisition, such as for eminent domain or partial acquisitions of property. In these cases MDT requires appraisers to comply with additional requirements outlined in the department’s appraisal policy manual. USPAP’s Jurisdictional Exception Rule allows law or public policy to supersede USPAP rules.

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### Who Conducts MDT's Appraisals?

Appraisals are conducted by both MDT employees and by private sector appraisers. The following sections describe the duties of each type of appraiser.

- ▶ MDT Right-of-Way Agents – Right-of-Way Agents are located in the district offices and report to the District Right-of-Way Supervisor. Right-of-Way Agents generally appraise less complicated parcels using the department’s DOV appraisal process. In addition, the Agents negotiate the majority of the department’s right-of-way acquisitions with property owners.
- ▶ Private-sector Appraisers – Private-sector appraisers (called fee appraisers) are employed under contract with the department. The department maintains a list of appraisers authorized to appraise property needed for right-of-way. All fee appraisers are state certified and are generally hired to assist the department with its appraisal work load. MDT occasionally hires fee appraisers to review appraisals and negotiate the purchase of property with property owners.



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### Appraisal Reviews

All appraisals are to be reviewed to verify the accuracy of calculations, assess the completeness of information contained in the appraisal, and ensure necessary appraisal standards and department policy was followed. Form appraisals are reviewed either by MDT or contract Review Appraisers and DOV's are reviewed by District Right-of-Way Supervisors. Appraisal reviews provide additional assurance that an appraisal contains a reasonable opinion of a property's value based on information available or known at the time of the appraisal. The Review Appraiser may concur with an appraiser's opinion or increase or reduce the value and provide a justification and information supporting any changes to the appraised value. For department acquisitions, a Review Appraiser's valuation determination becomes the department's just compensation determination and the basis of the department's offer to a property owner. Just compensation may not be less than the appraised value and in most cases equals the appraised value. However, just compensation can be greater than the appraised value since just compensation may also need to consider other impacts to a property or property owner over and above the appraisal amount.

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### The Negotiation Process

The second step of the right-of-way acquisition process involves negotiating the purchase with property owners. To protect the rights of property owners, the Uniform Act and federal regulations require the department to negotiate in "good faith" and prohibits efforts or attempts to coerce (i.e., force) property owners into right-of-way agreements. Additionally, the department must offer or provide property owners:

- ▶ An explanation of the right-of-way process.
- ▶ A written offer for the property, including a summary statement for the basis of the offer.
- ▶ Sufficient time to consider an offer.
- ▶ The opportunity to present additional information relevant to determining just compensation and suggest modifications to the proposed terms or conditions of purchase.

The department must consider all information property owners provide, but is not obligated to agree to the information. If the

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department determines the information affects the value of the property, it must make a prompt revised offer to property owners.

District right-of-way agents initiate most negotiations with property owners. Since right-of-way agents also appraise parcels, department policy prohibits right-of-way agents from both appraising and negotiating acquisitions of parcels greater than \$10,000. Department efforts to acquire properties can result in one of four different types of settlements with property owners.

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### Four Types of Acquisition Settlements Could Occur

The department's goal is to negotiate with property owners to reach an amicable right-of-way purchase agreement, or settlement. Ultimately, department efforts to acquire property can result in four different types of settlements, which are described below.

1. Negotiated settlement – Negotiated settlements occur when property owners agree to settle for what the department determines is just compensation based on the property's appraised value.
2. Administrative settlement – Administrative settlements occur when property owners and the department reach a final settlement that is more than the department's appraised value (i.e., just compensation determination). Department policy requires the bureau approve all district administrative settlement offers greater than \$5,000. Administrative settlements are commonly used to resolve differences in opinion between property owners and the department regarding property value.
3. Legal settlement – If the department and property owner cannot reach a negotiated or administrative settlement, negotiations transfer from the Right-of-Way Bureau to MDT's Legal Division. Once negotiations are referred to Legal Division, a new appraisal is obtained to get another opinion of the property's value. Legal Division staff considers this new information to conduct further negotiations with the property owner. A legal settlement occurs when negotiations between MDT's legal representative and the property owner results in the department successfully acquiring the property. The resulting settlement may be higher than appraised value and will include any attorney fees incurred by the property owner. According to MDT Legal Division officials, most property referred to the Legal Division is settled through a legal settlement.

4. Condemnation (Eminent Domain) – Condemnation is not used until all attempts to reach a mutually satisfactory agreement through negotiations are exhausted. If settlement cannot be reached through further negotiations, then formal condemnation proceedings begin. In the last 12 years, only three parcels of property have gone through formal condemnation proceedings (i.e., referred to a jury for trial). One parcel ended with an out-of-court settlement and two were referred to the district court to be settled by a jury.

### **How Much Right-of-Way Has Been Purchased?**

During federal fiscal years 2004 and 2005, the department acquired 1,644 parcels of right-of-way costing approximately \$24.8 million. This total included roughly \$2.7 million for negotiated settlements in which the department and property owner settled for the parcel's appraised value. Approximately \$18 million was spent acquiring parcels using administrative settlements. These settlements included payments to property owners of approximately \$10.3 million for the parcel's appraised value plus \$7.7 million above appraised value. The remaining acquisition costs were for legal settlements.

# Chapter III – The Right-of-Way Acquisition Process

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## Introduction

Our first audit objective addressed the Montana Department of Transportation's (MDT) process for appraising property and determining just compensation. This included determining if all property (i.e., parcels) is appraised to determine fair market value, if qualified appraisers conduct appraisals, and if appraisals are reviewed and just compensation determined.

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## MDT Appraises All Property Needed for Right-of-Way

An appraisal of the property is critical because it forms the basis of just compensation offered to the property owner. File reviews found MDT appraised all the property in our sample prior to making offers to property owners to acquire the property. In addition, the type of appraisal conducted was consistent with what is allowed by federal regulations and department policy. For parcels valued at less than \$10,000 with few complex valuation issues, the department used a determination-of-value (DOV) to appraise property. DOV's are the department's minimum standard appraisal format. For complex appraisals (regardless of estimated value), the department used procedures to appraise property using a long form appraisal format. However, we noted instances where MDT did not always use appraisal methods best suited for property acquired even though it was consistent with policy. These instances resulted in the department acquiring property through administrative settlements. This issue is discussed in the next chapter.

**Conclusion: The department appraises all property it must acquire for right-of-way purposes to determine fair market value.**

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## Qualified Appraisers Conduct Appraisals

Federal regulations and MDT policy require qualified appraisers be used to appraise property needed for right-of-way. According to the FHWA, it is the responsibility of the department to establish criteria outlining the minimum qualifications of appraisers. Appraisals for right-of-way are conducted by either the department's Right-of-Way Agents, MDT's Review Appraisers, or fee (i.e., contract) appraisers hired by the Right-of-Way Bureau.

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### **MDT Staff Generally Conduct Appraisals Based on Experience**

Department policy has specific criteria describing the educational and experience qualifications MDT appraisers must meet. In addition, the department provides appraisal training to staff to improve their skills and abilities in performing appraisals. District Right-of-Way Supervisors determine which MDT staff are qualified to appraise property needed for Right-of-Way on construction projects. District Right-of-Way Supervisors indicated they base appraisal assignments on staff qualifications and the complexity of appraisal issues. File reviews found appraisal assignments were generally commensurate with the appraiser's qualifications. Less experienced department staff was generally assigned less complex appraisals while more experienced staff completed appraisals on more complicated parcels. Most appraisals completed by MDT staff we reviewed in department files were determination-of-values (parcels valued less than \$10,000).

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### **Fee Appraisers Conduct Appraisals**

Department policy requires fee appraisers to be state licensed or certified in order to conduct appraisals for the department. We noted fee appraisers used by the department meet this requirement. The department has established several controls in the process to select qualified fee appraisers. First, while District Right-of-Way Supervisors determine if fee appraisers are needed, the Right-of-Way Bureau is responsible for hiring the appraiser. This maintains a level of independence in selecting appraisers responsible for appraising property that is often complex and acquisition, potentially controversial. The Right-of-Way Bureau also maintains a list of fee appraisers who are approved to conduct appraisals for the department and all appraisers hired by the department must be selected from this list. The approved list of appraisers was developed based upon appraiser qualifications, expertise, and past work experience with the department. Additionally, appraisers from this list are selected via competitive bid and MDT selects the appraisers most qualified to perform the appraisal work. Once selected, appraisers sign a contract with the department for the work performed. MDT pays appraisers half the contract price when the appraisal assignment is completed and the remainder after the department reviews and approves the appraisal.

## Chapter III – The Right-of-Way Acquisition Process

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**Conclusion: Department staff and private sector appraisers meet the qualifications for conducting right-of-way acquisition appraisals.**

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### Appraisals Reviewed by Appropriate Staff

The Uniform Act and MDT policy requires appraisals be reviewed to ensure they meet national appraisal standards, department appraisal policy, and to establish just compensation for the property. Our review of right-of-way parcels acquired by the department found all appraisals, including form appraisals and DOV's, were independently reviewed and approved by appropriate personnel. District Right-of-Way Supervisors generally review and approve DOV's and determine just compensation based on these appraisals. MDT has delegated the responsibility for reviewing long form appraisals to the Right-of-Way Bureau's Review Appraisers.

Our review of department appraisals found appraisers are required to make corrections to appraisals when errors were identified during reviews. Examples of corrections identified ranged from correcting math errors to requiring additional documentation or information on how appraisers determined the appraised value of the property. There was also evidence individuals reviewing appraisals discussed questions with appraisers and conducted field visits to the property to verify information in the appraisal. This helped improve the quality of the appraisals and allowed the department to establish just compensation that more accurately reflected the fair market of the property. Our review of appraisals found just compensation was generally the same as the fair market value noted in the appraisal. At no time did we find any instances where just compensation offered to property owners was less than the appraised value of the property.

**Conclusion: Appraisals are independently reviewed and approved by appropriate department personnel.**

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### Negotiations to Acquire Property

Negotiation is the process used by the department to reach an agreement with property owners for acquisition of needed property. After property is appraised and just compensation determined, written offers are made and discussed (i.e., negotiated) with property

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owners. The department's primary goal is to acquire the needed property through negotiations. Therefore, negotiations must be conducted in good faith, a rapport established with the property owners, and negotiations conducted in a positive manner.

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### Appraisal and Negotiation Process is Separate

To ensure independence and fairness in the negotiation process, regulations prohibit the same person who appraised the property also from negotiating the acquisition for any acquisition exceeding \$10,000. Audit work noted individuals appraising property did not conduct negotiations to acquire parcels. For more complex and/or high dollar acquisitions, the department generally used private appraisers to appraise property and MDT staff negotiated with property owners.

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### Negotiations Are Well Documented

The department maintains records documenting activities conducted by department staff during the negotiation process. These records document all activities that occurred during negotiations. Examples include meetings with property owners and comments made during these meetings. These records are considered a diary of all relevant activities on the parcel and can be used if the case goes to court. MDT staff document negotiation activities in the department's negotiation history log. Audit work found negotiations were generally well documented in these logs for all parcels reviewed during the audit. File documentation noted department staff emphasized fair treatment and interactions with property owners.

**Conclusion: Appraisals of property and negotiations to acquire property are conducted independently of each other. In addition, all negotiation activity is well documented and department staff emphasized fair and positive interactions with property owners.**

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### MDT Surveys Property Owners

The Right-of-Way Bureau surveys property owners from which MDT purchased property for right-of-way. The surveys are used to measure customer (i.e., property owner) satisfaction with the department's process to acquire property. The survey provides the department with input on how property owners were treated by department employees, if property owners were allowed input into

## Chapter III – The Right-of-Way Acquisition Process

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the process, if efforts to reach an agreement were handled in a professional manner, etc. Survey information is compiled and tracked statewide to obtain a statewide perspective of the department's efforts. In addition, individual questionnaires with comments are forwarded to the respective district for review. Based on a review of questionnaire results, it appears the majority of people involved in the right-of way acquisition process were allowed input and treated professionally.

**Conclusion: Most property owners responding to the department's right-of-way acquisition survey indicated they were allowed input into the process and treated professionally by MDT staff.**

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### Summary

Audit work found MDT's right-of-way acquisition process has a number of strengths that ensures the process generally works as intended. These strengths included:

- ▶ All property acquired for right-of-way purposes is appraised to determine its fair market value.
- ▶ Qualified individuals appraise property.
- ▶ Appraisals are reviewed and approved by appropriate personnel.
- ▶ Appraisals and negotiations were independent activities and property owners were generally treated in a fair manner.

Although the right-of-way acquisition process has several strengths, we noted the departments could make changes to improve the process. The following chapters discuss improvements the department could make in its right-of-way acquisition process to improve controls over administrative settlements. These areas include improving the appraisal process, negotiations with property owners, and general management of right-of-way acquisition.





# Chapter IV – Improving the Appraisal and Negotiation Process

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## Introduction

The second audit objective was to determine if the department's use of administrative settlements to acquire property is supported and justified. This chapter provides an explanation of administrative settlements and the extent they are used in the right-of-way acquisition process. It also discusses needed improvements in the appraisal and negotiation process to acquire right-of-way.

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## Administrative Settlements

The Montana Department of Transportation's (MDT) policy manual defines administrative settlements as any purchase of a right-of-way parcel for an amount over the initial appraised value of the property. According to the Federal Highway Administration (FHWA), administrative settlements are one tool to facilitate property acquisition needed for right-of-way. They can be used to settle differences of opinion between property owners and MDT and can be a cost effective way to resolve these differences if used appropriately. For example, administrative settlements may help the department avoid additional acquisition costs related to court proceedings or potentially excessive court awards. However, because administrative settlements result in MDT paying more than initial appraised value, controls are needed to ensure they are supported and justified. Consequently, it is important administrative settlements have documentation which justifies the decision to use them and support the additional acquisition costs for property.

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## MDT Acquires A Substantial Amount of Right-of-Way Using Administrative Settlements

MDT acquires a substantial portion of its right-of-way through administrative settlements with property owners. During federal fiscal year 2004 and 2005, MDT data indicates the department acquired 1,644 parcels at a cost of approximately \$24.8 million. Forty-five percent (748 of 1,644) of the parcels purchased were through an administrative settlement. Using administrative settlements, the department paid approximately \$7.7 million over appraised value (31 percent of total costs) to acquire right-of-way during this two-year time period. Administrative settlements are part of the right-of-way acquisition process and are expected to occur.

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### **Administrative Settlements are not Always Supported or Justified**

Since administrative settlements are a significant part of the acquisition process, federal regulations and department policy require they be fully justified, documented, and supported. Controls should exist to ensure this occurs. MDT has established an approval process for administrative settlements by requiring the Right-of-Way Bureau approve administrative settlements over district authority (up to \$5,000). However, audit work found administrative settlements are not always sufficiently supported, documented, and justified.

We noted improvements in several MDT control areas could help justify and support the use of administrative settlements. Specific areas where improvements could be made include:

- ▶ Property appraisal methods.
- ▶ Staff involvement in scope-of-work decisions.
- ▶ Ensuring appraisals reflect current market value.
- ▶ Improving the department's negotiation tactics.
- ▶ Improving documentation of acquisition activities.

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### **Improvements in the Appraisal Process Could Strengthen Controls Over Administrative Settlements**

The previous chapter noted appraisals are completed on all parcels the department acquires, qualified individuals perform appraisals, and appraisals are reviewed and approved. However, audit work noted improvements could be made to the department's appraisal process to improve controls over administrative settlements. The following sections discuss the needed improvements.

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### **MDT Does Not Always Use Correct Appraisal Methods**

Even though qualified individuals perform appraisals and they are reviewed and approved, right-of-way parcels were not always appraised using correct appraisal methods. For example, some appraisals did not always use appropriate comparable properties, as required by appraisal standards, to calculate fair market values. In addition, files did not always contain sufficient documentation indicating how valuations were determined. Our sample also identified seven instances where a determination-of-value (DOV) was used to determine property values when a long form appraisal would have provided a more accurate valuation. For example, one

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DOV valued a property at approximately \$3,000 but the department acquired it for more than \$31,000. File documentation indicated the additional cost items (such as a septic tank) were missed because MDT staff used an incorrect appraisal method.

Using incorrect appraisal formats gives an impression the department is trying to “short cut” the appraisal process in an attempt to acquire parcels more quickly. In addition, it does not ensure property owners are offered just compensation in initial written offers to acquire property. The following provides some additional examples of administrative settlements that occurred because the department did not use the most appropriate appraisal format. This resulted in incorrect initial property valuations and offers to property owners.

- ▶ A parcel appraised for \$7,300 and was settled with an administrative settlement for \$26,650. File documentation indicated the appraisal incorrectly valued the per acre value of the property and did not include replacement of items such as a septic system, a garage, and fencing. File information indicated these items were not included because a DOV was completed instead of a form appraisal.
- ▶ A DOV valued a parcel for \$850 and was settled with an administrative settlement for \$19,850. File documentation indicated a garage located on the .11-acre parcel was not included in the initial property valuation of the parcel. MDT personnel indicated a form appraisal should have been initially completed on this parcel.
- ▶ Property near a gravel operation was valued at \$9,750. The department ultimately settled using an administrative settlement for \$67,000. File documentation indicates original appraisal should have used similar properties, such as other gravel operations, as comparison property in the appraisal to obtain more accurate property values.

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### **Include Review Appraisers in Scope-of-Work Development**

Appropriate appraisal formats were not always used because districts often did not include Review Appraisers in establishing the appraisal scope-of-work. MDT’s appraisal staff, including the Appraisal Supervisor and Review Appraisers, is generally the department’s most experienced appraisal staff but indicated they are usually not involved in the scope-of-work process. Therefore, they have limited input in determining the type of appraisal or potential issues that

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could arise affecting the complexity and value of the property. Involving Review Appraisers in the scope-of-work process could be an additional control in the appraisal process. For example, District Right-of-Way Supervisors are involved in developing the scope-of-work to determine the type of appraisal to complete on property. However, department policy also allows District Supervisors to review and approve DOV's completed by staff within their districts. Involving Review Appraisers in the scope-of-work would create a check-and-balance to ensure the correct property valuation method is used.

According to MDT appraisal policy, a scope-of-work should be conducted for all appraisal assignments. A scope-of-work is a written set of expectations between the appraiser and the department on the specific requirements of the appraisal. This includes determining the type of appraisal to complete.

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### Extent of Involvement Needs to be Addressed

The department acquired more than 1,600 parcels of property over the last two years. However, the Appraisal Supervisor and Review Appraisers constitute only five FTE within MDT's Right-of-Way Bureau so it may not be possible to involve appraisal staff in all aspects of the scope-of-work process for all parcels. Therefore, MDT needs to ensure Review Appraisers are used in the most efficient means possible. The department should develop formal criteria regarding the extent of Review Appraiser involvement based on the type of property acquired. Appraisal staff should be formally involved in the scope-of-work process for all parcels, but the extent of their involvement could be based on "risk factors" identified by the department. For example, the department may want to involve appraisal staff in all aspects of the scope-of-work process where construction projects are going through areas experiencing rapid growth, rapidly rising property values, or where the department has had difficulty acquiring parcels. In other areas, the input of Review Appraisers would be less involved.

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### **Recommendation #1**

**We recommend the department improve its appraisal process by involving Right-of-Way Bureau Review Appraisers in developing the scope-of-work for appraisals in all districts.**

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### **Offers Based on Outdated Appraisals**

We noted outdated appraisals were used as the basis on several occasions to make offers to property owners. For example, one parcel had an appraisal that was 525 days old (approximately a year-and-a half). As a result, the department paid the property owner approximately \$118,000 over the appraised amount to account for several issues, including rapidly rising property values in the area. In another district, we reviewed five parcels in which outdated appraisals were a contributing cause to administrative settlements. The average size of the administrative settlements of these five parcels was \$53,010.

Outdated appraisals resulted in ineffective negotiations with property owners and started the department's discussions off on the "wrong foot." There were times negotiations became relatively confrontational over the outdated values in the appraisal. MDT staff said they are required to use completed appraisals of the property and used the outdated appraisals since they had already been completed and just compensation was determined. In most cases, using outdated appraisals can result in property owners not being offered just compensation or the department acquiring property for less than fair market value of the property.

FHWA regulations and department policy require the department use a property's current appraised value. Supply, demand, and market conditions cause increases or decreases in property values. Therefore, the length of time appraisals are valid depends on the area of the state property is located. MDT's policy manual states appraisals six to twelve months old require updating for circumstances where extensive market changes have occurred. For example, appraisals will remain current longer in areas where

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property values are relatively stable. In areas such as the Bitterroot or Flathead Valley, appraisal information will become outdated much sooner because of rapidly changing property values. Appraisers indicated outdated appraisals should not be used in making offers to property owners because the department is not offering just compensation based on current market conditions or fair market value of the property.

Federal regulations and department policy recognize there are times when appraisals will become outdated. For example, MDT construction priorities can change resulting in outdated appraisals. However, when appraisals become outdated they should be updated to ensure property owners are offered just compensation for their property. The department's policy manual provides for a number of different ways to update appraisal information. Examples include:

- ▶ A new appraisal should be completed if significant changes have occurred in the market place that could influence the fair market value of the property.
- ▶ In some cases, the department could use its sales catalog to update property values noted in the appraisal. A sales catalog is a document that provides sales data for property on a construction project and is used by appraisers to update property information as needed.
- ▶ Property owners may have new information that was not included in the appraisal or available when the appraisal was conducted. The department can use this information in deciding whether an appraisal should be updated or a new just compensation estimate established.

In some instances, we noted district staff updated appraised value using the department's sales catalog. However, we noted that unless a parcel was referred to MDT's Legal Division, outdated appraisals were generally not revised prior to making offers to property owners. In addition, MDT staff said they often address the need to pay higher compensation to property owners due to outdated appraisals using the administrative settlement process. However, without updating property valuations it is not possible to ensure property owners are offered or paid just compensation or if the department paid too much

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for the property through the administrative settlement. MDT staff interviews found acquiring parcels quickly often took priority over ensuring written offers or final settlements were appropriate.

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### **MDT Should Update Appraisals Prior to Making Offers**

In some cases, appraisals became outdated because they were not reviewed in a timely manner by department staff. In other cases, changing priorities for construction projects impacted when appraisals were used to acquire property. Department policy requires appraisals be updated when they are six to twelve months old or when changes in market conditions warrant appraisal updates. However, these updates should occur prior to making initial offers to property owners to ensure just compensation is offered.

#### **Recommendation #2**

**We recommend the department comply with policy by updating appraisal information prior to making initial offers to property owners to ensure appraisals reflect current market conditions.**

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### **Negotiation Process Can Be Improved**

Although we noted some good negotiation practices, inconsistencies exist in methods used to negotiate acquisitions with property owners. Parcels settled in an efficient manner had several common characteristics. These included department staff being responsive to property owner's requests, working to build a good rapport with property owners despite issues that arise, and being willing to consider new information provided by property owners that could affect the value of the property. In these cases, the department generally acquired property relatively quickly at a price that was close to the appraised value of the property.

However, there were negotiations with property owners that were not conducted in an efficient manner. These inefficiencies lead to longer negotiations and administrative settlements that increased the cost of acquiring the parcel. Examples of weaknesses in negotiations noted during file reviews included using outdated information to initiate



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negotiations with property owners, not acknowledging counter offers from property owners, and the department not always making counter offers. For example, we identified a parcel where MDT staff did not respond to a property owner's counter offer for several months. The property owner eventually withdrew their offer and submitted another counter offer for a much higher price. This lack of responsiveness cost the department an additional \$61,000 through an administrative settlement payment. MDT personnel stated this was a negotiation tactic they use to let property owners think about the offer. We also noted examples where the negotiation history claimed counter offers were made to property owners but evidence did not always exist that the offers were actually made. These counter offers were used in some cases to support acquisition of the parcel at a higher cost using an administrative settlement when property owners did not accept the offer.

Federal regulations require the department complete negotiations with property owners as quickly as possible. They also prohibit coercive tactics in negotiation such as deferring or delaying negotiations or threatening condemnation as a means to settle a parcel. There were some parcels where MDT staff told property owners that condemnation proceedings would be undertaken if an agreement could not be reached. However, it did not appear these tactics were always appropriately used. For example, files where condemnation was discussed during negotiations generally did not contain documentation that department staff obtained input from MDT Legal Division indicating condemnation might be necessary to acquire the parcel. The FHWA's Project Development Guide recommends advice be obtained from department legal counsel before potential condemnation is discussed in negotiations.

The appraisal process and negotiations are tied closely together because information from appraisals is used to make offers and negotiate purchase of property. Previous recommendations for improving the appraisal process will also help improve the department's negotiation process. For example, updating appraisals when needed will help ensure negotiations start with correct property

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values and reduce the need to reach agreements using administrative settlements. In addition, Right-of-Way Bureau officials have developed a training plan that includes training on how to conduct negotiations. Staff has received both classroom and on-the-job training related to negotiations.

Right-of-Way Bureau officials believe right-of-way policy is clear regarding the bureau's expectations when negotiating with property owners. However, policies do not clearly specify negotiation tactics considered to be unacceptable, such as those violating federal regulations. The Right-of-Way Bureau does not currently have a system to identify weaknesses in negotiations and determine what caused delays or other problems leading to additional acquisition costs through administrative settlements. The Right-of-Way Bureau should develop a system that enables them to identify problems with negotiations, ensure policy is adhered to, and address problems with district staff so they do not occur in the future.

### **Recommendation #3**

**We recommend the Right-of-Way Bureau clarify Right-of-Way acquisition policies regarding:**

- A. Counter offer and response requirements.**
- B. Legal input documentation requirements.**
- C. Acceptable negotiation tactics and timeframes.**

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### **Improving Documentation of Acquisition Activities**

Files included documentation supporting property valuations and specific costs, such as invoices and estimates for repairing or replacing fences or wells. However, when acquisitions resulted in administrative settlements (payments exceeding the department's just compensation determination), files did not always contain documentation or information justifying the administrative settlement. Most significantly, we noted that as administrative settlement amounts increased in relation to the department's just compensation determination, there tended to be less documentation or information justifying the administrative settlement decision.

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Examples of acquisitions with poor or limited documentation supporting administrative settlements included:

- ▶ MDT spent almost \$220,000 to acquire a 0.69-acre parcel that the department appraised at approximately \$18,000. This parcel was part of a larger property the department appraised at approximately \$133,000. Although department policy states acquisition personnel consider a “total take” if the acquisition costs exceed the appraised value of the property, file documentation did not indicate whether this option was considered. Department personnel mentioned during subsequent interviews that acquiring similar property for the owner would have been more costly, but the file did not contain documentation supporting this statement.
- ▶ In the previous acquisition, district personnel did not document or explain the necessity for spending \$167,000 to construct a road to another location on the property the owner was considering for a new home. Although the file indicated the property owner was concerned about the proximity of the home to the road, the appraiser also indicated proximity to the road was no different than other parcels the department had previously acquired.
- ▶ The department paid significantly higher costs for a property based on a property owner’s statement of other property sales in the area without verifying the other sales. Additionally, department personnel justified the additional costs since other acquisitions in the area had similar administrative settlements.
- ▶ The department paid \$67,000 for a property initially valued at \$9,750. File documentation indicated the additional amount was based on the property owner’s statement of the value of gravel being extracted, but did not include any documentation from the property owner supporting the value.

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### **FHWA Requires Clear Justification of Administrative Settlements**

File documentation is evidence that actions or transactions occurred and allowed supervisory and managerial reviews. Federal Highway Administration (FHWA) guidelines encourage judicious use of administrative settlements to avoid court costs and potentially large court awards, to recognize the inexactness of appraisals, and to meet the intent of the law. The FHWA considers administrative settlements less than \$5,000 to be cost effective and requires minimal documentation justifying these settlements. However, larger administrative settlements require justification. FHWA guidelines

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also emphasize as the amount of an administrative settlement increases above the appraised value (just compensation), better documentation supporting the decision is necessary. Poor documentation results in:

- ▶ Difficulty in monitoring acquisition activities and decisions.
- ▶ Using administrative settlements as an easy way to resolve difficult negotiations.
- ▶ Setting unwanted precedents for acquiring right-of-way on projects.
- ▶ Actual or perceived unfairness to property owners who settled for appraised value (or just compensation).
- ▶ Increased perception by property owners that “holding up” the process result in larger settlements.

Ultimately, poor documentation reduces the department’s ability to demonstrate accountability for public funds used to acquire properties for highway projects.

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### **The Department Should Clarify Administrative Settlement Documentation Requirements**

Bureau policy states administrative settlements must be justified based on “what available information, including trial risks, supports such a settlement.” However, policy does not provide any further guidance. Consequently, justifications were sometimes limited to general statements regarding a property owner’s unwillingness to sell or statements that the settlement is in the “best interest of the state” with no supporting details or explanation of why the settlement was in the state’s best interest.

Examples of documentation we identified in other files that provided better justification included:

- ▶ Legal issues with appraisal increased risk the property owner would prevail in court.
- ▶ Documentation of estimated court costs exceeding administrative settlement costs.
- ▶ Property owner would likely prevail before a jury because adjacent properties, although having different uses, were sold for what the property owner is offering the department.

## Chapter IV – Improving the Appraisal and Negotiation Process

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- ▶ Property owner used a different valuation methodology than the department that is difficult to dispute before a court.

The department could expand existing policy to clarify expectations, potentially including examples or scenarios of acceptable justification.

### **Recommendation #4**

**We recommend the department clarify bureau policy regarding administrative settlement documentation requirements.**

# Chapter V – Improving Controls in the Acquisition Process

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## Introduction

Our third objective was to determine whether the Right-of-Way Bureau had management information for effective and efficient program administration. Initial audit work indicated the department could improve its management information. However, we found this issue was symptomatic of the need to improve a number of controls over the acquisition process. This chapter presents findings and recommendations for improving controls in the following areas:

- ▶ Data collection for the bureau's information tracking and reporting system.
- ▶ Intra-department communication.
- ▶ Quality control and assurance procedures.

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## Data Collection and Reporting System

To facilitate data reporting and analysis, the bureau tracks selected acquisition information into the department's integrated database. Examples of acquisition information entered into the database include parcel identification, appraisal dates, valuation information, and final settlement amounts. Our examination included determining whether database capabilities meet bureau needs and evaluating whether the bureau collects information necessary for effective and efficient program administration.

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## Department Database Meets Management Information Needs

The department's database is a commercial application commonly used by business and government organizations. Department information technology (IT) personnel stated the database is capable of storing and retrieving any program data necessary to meet bureau reporting and management needs. IT personnel can create onscreen forms to facilitate data entry and establish input controls to increase assurance data is entered correctly. Some department personnel stated using the database can be difficult and frustrating. However, personnel also stated the department provides database training and is working to make the system more user-friendly. Audit work indicated the department's database is capable of meeting bureau reporting and management information needs.

## Chapter V – Improving Controls in the Acquisition Process

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### **Right-of-Way Program Data Has Limited Usefulness**

Current data has limited usefulness in managing right-of-way acquisition activities. This is because the Right-of-Way Bureau does not collect some data that would be useful nor consistently enters information into the database. As a result, some bureau personnel have begun compiling their own separate information. Examples of data deficiencies identified included:

- ▶ Most property values are recorded as the initial appraised value and are not updated if new valuation information is identified.
- ▶ The bureau does not break out different components of acquisition costs, such as land value, damages, or legal costs.
- ▶ Some process dates, such as the date a parcel assigned to staff for action, are not collected.
- ▶ Department personnel do not consistently enter right-of-way acquisition data into the department database.

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### **FHWA Recommends Quality Data for Measuring Performance of Right-of- Way Activities**

The FHWA recommends state highway departments collect quality data as part of a performance measurement system. A performance measurement system is a tool for managing the effectiveness and efficiency of agency activities. Without quality data, agencies are less able to determine whether they are meeting expected standards or evaluate whether operational or management changes achieved desired results.

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### **Data Collection Problems Impact MDT Reporting and Management Efforts**

During the audit, we determined data collection problems were affecting several management or operational areas related to right-of-way acquisition. Department personnel also stated data quality was a management concern. Examples of problems related to poor management information are discussed below.

- ▶ Some Administrative Settlements May Be Misstated – The department typically tracks only the just compensation determination amount used for its initial offer, not the final just compensation determination. Consequently, new valuation information related to just compensation is included in administrative settlement calculations, which results in administrative settlements being misstated. For example, in one file the department determined just compensation for a parcel was \$850. Right-of-Way personnel subsequently determined a garage on the parcel needed to be replaced at a cost of \$19,000.

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Since the department tracks only the initial just compensation determination, this acquisition recorded a \$19,000 administrative settlement, although documentation indicated the entire payment appeared to be just compensation.

- ▶ Bureau Cannot Measure Time To Complete Acquisition Steps – We attempted to use bureau data to evaluate average times for completing various steps in the acquisition process. Since the bureau does not track some process dates, such as dates appraisal reviews are completed, we were unable to use the data. In other instances data was unreliable because personnel did not enter information requested/required.
- ▶ Bureau Cannot Track Other Acquisition Costs – In addition to administrative settlement costs, the bureau is unable to track some other costs such as actual property value, damages, costs-to-cure, access control costs, and legal fees.

While the department collects data, it has not clearly identified what data is necessary to effectively manage right-of-way activities.

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### **A Performance Measurement System Would Help Identify Necessary Data**

Valid performance measurement systems require agencies to establish measurable objectives and identify quantifiable performance measures that allow agencies to measure progress. Agencies may use more than one performance measure to measure an objective. For example, a bureau objective could be to complete a percentage of administrative settlements within a specified time, and measured the time to complete each process step. Performance measures would help the bureau determine specific information necessary to effectively manage right-of-way acquisition activities and provide assurance data collected will be relevant to program objectives (management information needs). Table 1 provides additional examples of the use of a performance measurement system.



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**Table 1**

**Examples of Additional Data the Bureau Could Collect For Right-of-Way Acquisition**

<b>Data Uses</b>	<b>Type of Data</b>
Evaluating effectiveness of parcel scoping and determining whether staff are using the appropriate valuation methods.	Property scoping information, such as reasons for type of valuation conducted.
Determine whether reviews are timely or contribute to aged appraisals.	Date valuation (appraisal and DOV) review started and was completed.
Determine factors affecting costs and causes related to administrative settlement amounts. This information can be useful in projecting acquisition costs.	Parcel acquisition expenditures by cost category.
Evaluate appraisal quality and identify potential training issues for appraisers. This information also could be used to evaluate staff and fee appraisers.	Appraisal review changes.

**Source: Compiled by the Legislative Audit Division.**

### **Improving Reliability of Management Information**

Once the Right-of-Way Bureau decides what data is needed to effectively manage right-of-way acquisition, the bureau should implement controls to assure collected data is relevant, complete, and accurate. This includes updating just compensation estimates as necessary, measuring timelines to acquire parcels, and tracking all acquisition costs. Data quality controls should include:

- ▶ Ongoing data assessment to determine whether collected data is relevant and accurately reflects performance to be measured. Initially, these assessments determine whether data collected accurately addresses identified objectives and performance measures. Subsequent assessments are necessary to determine whether processes or other factors have changed that require updating data collection requirements and modifying a database.
- ▶ Using available database system controls to increase assurance personnel enter accurate and complete data, such as restricting who may enter data into specific fields or requiring data entry meet established criteria.

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- ▶ Supervisory or file closure reviews to verify personnel entered required data.

Bureau management said it is working on improving data collection and reporting. However, implementation of some requested improvements have been delayed due to other department IT priorities. Since the bureau has not formally identified and defined data necessary to meet its management information needs, developing objectives and performance measures pending implementation of requested improvements would help ensure data is relevant.

### **Recommendation #5**

**We recommend the department improve its right-of-way data collection by:**

- A. Implementing a performance measurement system that includes program objectives and performance measures.**
- B. Collecting management information that is relevant, complete, and accurate to determine if objectives are being met.**

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### **Intra-Department Communication Could Be Improved**

A common issue we identified during our file review, and confirmed during interviews, was limited communication among districts and Helena central office personnel and management. Examples of limited communication included:

- ▶ Districts exceeding administrative settlement fiscal authority. For example, one district did not obtain bureau approval for a \$21,200 settlement that was 42 percent over the appraised value.
- ▶ District or bureau personnel did not consistently contact legal counsel for assistance with negotiations.
- ▶ Bureau personnel expressed concerns that district personnel may provide only limited information when requesting approval for administrative settlements.
- ▶ District and bureau personnel commonly do not request bureau appraisal personnel to review new information that may affect property valuations, just compensation, or administrative settlements.

## Chapter V – Improving Controls in the Acquisition Process

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- ▶ District and bureau personnel do not consistently use established “chain of authority” for approving settlements. Consequently, persons responsible for administrative settlements are not aware bureau management had already approved some district settlements.
- ▶ Limited communication among districts to discuss acquisition problems or best practices. For example, we noted best practices in districts that other districts were not necessarily using.

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### **Communication is an Essential Organizational Control**

Communication is an organizational control component, essential for transmitting information among department entities involved in acquisition activities. It is essential for ensuring management conveys department objectives, policies, and procedures to staff, and for staff to inform management about operational problems and successes. Effective communication is also essential for coordinating acquisition activities among managers and staff with assigned responsibilities. For example, communication between district right-of-way and bureau personnel and department legal counsel can facilitate the process when potential just compensation issues arise. Department legal counsel can provide advice on whether property owner compensation demands are reasonable or excessive or whether pursuing an acquisition through the condemnation process is legally appropriate. Additionally, FHWA guidelines discuss the importance of communication among acquisition personnel to assure that settlements accurately reflect acquisition costs.

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### **Poor Communication Adversely Impacts the Acquisition Process**

File reviews indicated limited communication contributed to not accurately documenting acquisition activities and negotiation delays. Ultimately, limited communication appeared to slow the acquisition process and increased administrative settlements and acquisition costs. For example, not involving Review Appraisers in the scope-of-work process (discussed in Chapter IV) resulted in incorrect appraisals being conducted. Another example is district and bureau personnel do not typically involve the department’s appraisal staff in reviewing the validity of new information obtained during negotiations that impact property valuations and just compensation. Consequently, valuation information is often reported

## Chapter V – Improving Controls in the Acquisition Process

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as part of an administrative settlement. For example, a district increased the value of a property by \$21,000 because of increasing property values in the area but did not have a review appraiser determine whether that adjustment was appropriate. Additionally, if review appraisers determine some costs are actually related to just compensation, which reduced an administrative settlement to within district authority amounts, districts would not have to seek additional authority from the bureau.

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### **Department Should Increase Emphasis on Intra-Agency Communications**

Although districts, the bureau, and several other department entities are commonly involved in the acquisition process, the department has not emphasized the need for better communication, including their respective roles and responsibilities. For example, district right-of-way personnel said seeking assistance from bureau or legal personnel was often perceived as a “failure” of district negotiation efforts. We also noted improving communication between bureau management, the acquisition section, and the appraisal section could improve documentation and justification for administrative settlements.

Decentralized organizational structures have greater risks that districts become insulated from other department functions. Decentralized units have a natural tendency to focus on their immediate activities and become less involved or separated from the organization as a whole. Consequently, decentralized organizations must identify and implement compensating communication strategies. For example, other decentralized organizations we audited implemented annual statewide staff conferences or training sessions and periodic management team meetings to bring staff together and better coordinate statewide activities. Additionally, these strategies also facilitate professional relationships among units and encourage/strengthen ongoing intra-departmental communications.

The department should identify and implement strategies to improve intra-department communications. To help address this issue, the bureau has implemented quarterly meetings with District Right-of-Way

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Supervisors. The bureau also recently re-scheduled statewide right-of-way meetings, which were canceled when some districts decided to not participate. The department should reemphasize the importance of intra-agency communication by continuing existing quarterly right-of-way supervisor meetings and implementing mandatory annual statewide right-of-way meetings. Other steps the department should take include formalizing the process for involving legal counsel in right-of-way acquisitions, involving department appraisal staff in administrative settlement reviews, and clarifying the chain of authority for approving administrative settlements.

### **Recommendation #6**

**We recommend the department identify and implement strategies to improve intra-departmental communications.**

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### **Implementing a Quality Control System**

Throughout this report we have presented information, findings, and recommendations for improving the acquisition process such as:

- ▶ Improving the timeliness of appraisal reviews.
- ▶ Conducting new appraisals when new valuation information is identified.
- ▶ Improving the negotiation process.
- ▶ Updating appraisals if necessary before making initial offers to property owners.
- ▶ Clarifying policy regarding documenting administrative settlements.
- ▶ Improving data collection.

These recommendations addressed direct causes of our findings. However, the underlying cause of weaknesses we identified was the department did not have a quality control system in place.

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### **Quality Control Programs Verify Compliance with Program Policies and Standards**

Agencies implement quality control systems to verify personnel comply with established agency policies and monitor program activities and operations. Typically, quality controls are the joint

## Chapter V – Improving Controls in the Acquisition Process

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responsibility of program management, supervisory personnel, and staff. Examples of common quality controls include:

- ▶ Supervisory reviews of staff work products.
- ▶ Supervisory or staff checklists verifying required information or steps are completed.
- ▶ Data entry controls to increase data accuracy.
- ▶ Staff or supervisory reviews before closing out files to ensure files include all required documentation.
- ▶ Testing a sample of files to verify compliance with policies.

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### Department is Developing a Quality Control System

An effective quality control system would help the department improve the acquisition process and internal controls. The department is in the process of developing and implementing a formal quality control system for the acquisition process. The department's preliminary draft plan provides the basic framework for improving quality control such as:

- ▶ Developing a checklist to verify required documentation and activities are completed for each acquisition.
- ▶ Identifying and tracking critical activities and data.
- ▶ Establishing supervisory and management reviews of acquisitions.
- ▶ Assessing personnel training.
- ▶ Analyzing data to identify risk areas.
- ▶ Monitoring selected projects from each district.

As the department continues developing its quality control system, it should also begin determining how to best implement the program. Implementation should include:

- ▶ Identifying risk areas needing quality controls.
- ▶ Identifying baseline information and developing standards for reviews.
- ▶ Establishing specific objectives for quality controls.
- ▶ Developing written guidelines specifying who is responsible for reviews.

## Chapter V – Improving Controls in the Acquisition Process

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- ▶ Ensuring that guidelines and reviews are applied consistently to all districts.
- ▶ Identifying risks and priorities for quality control activities.

We also believe the department should consider modifying its proposed quality control activities. The department's quality control plan places responsibility for quality control reviews primarily at the district level. However, this does not ensure statewide consistency and compliance with right-of-way laws and policies.

Other state agencies with decentralized structures have implemented quality control steps that include both field (district) and central office (bureau) personnel. Implementing statewide controls involving representatives from all districts and the bureau can result in several benefits. Work relationships developed during statewide reviews can improve communication and coordination among district and bureau personnel. District personnel are also exposed to effective new practices or strategies used in other districts. Most importantly, statewide quality control reviews emphasize that quality controls are a department commitment, not just district or bureau "activity."

While implementing a quality assurance program and initial reviews can require substantial resource investment, ongoing reviews commonly require fewer resources as agencies continue to improve operation.

### **Recommendation #7**

**We recommend the department:**

- A. Modify its quality control system to ensure state-wide consistency and compliance.**
- B. Formally implement the program as an ongoing department oversight function of right-of way acquisition activities**





## **Department Response**

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*Montana Department of Transportation***Legislative Audit Division Audit Response and Agency Recommendations****Recommendation #1**

We recommend the department improve its appraisal process by involving Right-of-Way Bureau Review Appraisers in developing the scope-of-work for appraisals in all districts.

**Response**

Concur

Currently the department does this on some projects, but there is no criterion to determine when it should or should not be done. We will develop criteria to identify when a Review Appraiser should be involved in the scope-of-work and formalize this into our ROW Manual.

**Recommendation #2**

We recommend the department comply with policy by updating appraisal information prior to making initial offers to property owners to ensure appraisal reflect current market conditions.

**Response**

Concur

The department has a policy to review information if it is older than six months. We will clarify that policy and shorten the time frame for fast growing areas. We will ensure the consistency of the policy through our QA/QC process that is currently under development.

**Recommendation #3**

We recommend the Right-of-Way Bureau clarify right-of-way acquisition policies regarding:

- A. Counter offer and response requirements.
- B. Legal input documentation requirements.
- C. Acceptable negotiation tactics and timeframes.

**Response**

Concur

We will review our policies and procedures as it relates to this area. We will clarify policies as appropriate.

**Recommendation #4**

We recommend the department clarify bureau policy regarding administrative settlement documentation requirements.

**Response**

Concur

We will review our policies and procedures as it relates to this area. We will clarify policies.

**Recommendation #5**

We recommend the department improve its right-of-way data collection by:

- A. Implementing a performance measurement system that includes program objectives and performance measures.
- B. Collecting management information that is relevant, complete, and accurate to determine if objectives are being met.

**Response**

Concur

The department is in the process of modifying its ROW database. This modification will provide the tools necessary to measure our performance. The database has been scoped and is in the IT queue for actual programming. Once it is completed we will develop the measurement criteria and measure our performance.

**Recommendation #6**

We recommend the department identify and implement strategies to improve intra-departmental communications.

**Response**

Concur

In late 2005 the ROW Bureau started having quarterly supervisor meetings to assist in communication. The bureau will continue to have these meetings. The Bureau also will continue to have annual training/development meetings to ensure the chains of communication are functioning. In addition to this, we will clarify the chain of authority for approving administrative settlements. This will be formalized into the ROW manual.

**Recommendation #7**

We recommend the department:

- A. Modify its quality control system to ensure state-wide consistency and compliance.
- B. Formally implement the program as an ongoing department oversight function of right-of-way acquisition activities.

**Response**

Concur

The department started to develop a QA/QC process this summer. It will complete that development and formalize the process to ensure activities are performed consistently and in compliance with the right-of-way.

**Management Action Plan - LAD Audits**  
**MDT Financial / Compliance Audit**  
For the two Fiscal Years Ending June 30, 2004 and 2005

Audit Recommendation #	Does this affect a federal program?	Management View	Corrective Action Plan	Responsible Area	Target Date
<b>Recommendation #1</b> We recommend the department improve its appraisal process by involving Right-of-Way Bureau Review Appraisers in developing the scope-of-work for appraisals in all districts.	Yes	Concur	1. We will develop criteria to identify projects where earlier involvement in the development of scope of work by review appraisers would be beneficial and provide for that process. 2. We will modify the ROW Manual to address this new process.	Right of Way	1/31/07  2/28/07
<b>Recommendation #2</b> We recommend the department comply with policy by updating appraisal information prior to making initial offers to property owners to ensure appraisal reflect current market conditions.	Yes	Concur	1. We will modify our ROW manual to require that, in areas of rapidly changing property values, offers will not be made using any appraisal more that 3 months old without either documenting that values are still current or updating the appraisal itself. In any case, offers will not be made using any appraisal more than 6 months old without the same documentation or update. 2. We will finalize the ROW QA/QC process. Within that process we will ensure that the supervisors are checking to ensure information is updated in accordance with the ROW manual.	Right of Way	2/28/07  12/31/06
<b>Recommendation #3</b> We recommend the Right-of-Way Bureau clarify right-of-way acquisition policies regarding:  A. Counter offer and response requirements. B. Legal input documentation requirements. C. Acceptable negotiation tactics and timeframe	Yes	Concur	1. We will review and clarify the policies with regard to the areas identified. 2. We will update the ROW manual to reflect these changes.	Right of Way	1/31/07  2/28/07
<b>Recommendation #4</b> We recommend the department clarify bureau policy regarding administrative settlement documentation requirements.	Yes	Concur	1. We will review and clarify the policies with regard to the areas identified. 2. We will update the ROW manual to reflect these changes.	Right of Way	1/31/07  2/28/07
<b>Recommendation #5</b> We recommend the department improve its right-of-way data collection by: A. Implementing a performance measurement system that includes program objectives and performance measures. B. Collecting management information that is relevant, complete, and accurate to determine if objectives are being met.	Yes	Concur	1. We are in the process of modifying the ROW database to capture the data necessary to measure performance. 2. Once this is complete, we will develop criteria for measuring performance and start monitoring it.	Right of Way	7/1/2007  12/31/07
<b>Recommendation #6</b> We recommend the department identify and implement strategies to improve intra-departmental communications.	Yes	Concur	1. We will ensure the continuation of the quarterly supervisor meetings and the annual training/development meetings. 2. We will clarify the chain of authority for approving administrative settlements. 3. We will update the ROW manual to reflect the clarification	Right of Way	on-going  1/31/07 2/28/07
<b>Recommendation #7</b> We recommend the department: A. Modify its quality control system to ensure state-wide consistency and compliance. B. Formally implement the program as an ongoing department oversight function of right-of-way acquisition activities.	Yes	Concur	We will complete the development of the QA/QC process and formalize the process.	Right of Way	12/31/2006